(9)

DEC 2 1944
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

No. 720.....

TERM A. D. 1944.

F. G. BADENHAUSEN, WILLIAM S. SPATCHER and HOWARD H. HUBBARD, constituting the Protective Committee for the Holders of Georgia and Alabama Railway First Mortgage Consolidated Five Per Cent. Gold Bonds, Due 1945,

Petitioners and Appellants Below,

AGAINST

GUARANTY TRUST COMPANY OF NEW YORK and MERREL P. CALLAWAY, as Trustees of Seaboard Air Line Railway Company First and Consolidated Mortgage, dated September 1, 1915; *et al.*,

Respondents and Appellees Below.

—o—

IN THE CAUSE

OF

Guaranty Trust Company of New York and Merrel P. Callaway, as Trustees, et al., Complainants v. *Seaboard Air Line Railway Company, et al., Defendants.* Consolidated Cause. In Equity No. 214. And in the constituent causes numbered 213, 214, 228, 229, 172, 173, 174, 237 and 238 of said consolidated cause.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit, and Brief in Support Thereof.

ABRAHAM MITNOVETZ,
Attorney for Petitioners.

HARRY O. LEVIN,
Of Counsel.

LODER APPEAL PRESS, INC., 65-67 Duane St., N. Y. C., Tel. WOrth-2-0689

INDEX.

PAGE

PETITION:

Summary Statement of the Matter Involved 2

Facts as to Seaboard System 2

Facts as to the Georgia and Alabama Railway 7

This Court Has Jurisdiction 12

Questions Presented 12

Reasons Relied on for Allowance of Writ 15

BRIEF:

Opinions Below 23

Jurisdiction 23

Statement of the Case 23

Specification of Errors 24

POINT I.—The District Court erred in proceeding to reorganize the Seaboard Railroad System in Equity after the passage of Section 77 of the Bankruptcy Act 25

POINT II.—The Circuit Court of Appeals erred and violated the due process of law guaranteed by the Federal Constitution in sanctioning the appointment by the District Court of a Compromise Committee consisting only of representatives of certain partisan interests, which purported to act in a judicial capacity over issues affecting the petitioners, as well as the other bondholders of the system.

PAGE

The Circuit Court of Appeals, in sanctioning the procedure of the District Court with respect to the Compromise Committee, so far sanctioned a departure by a lower court from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

The allocation of securities recommended by the Compromise Committee and approved by the lower Courts, were arbitrary and illegal, without any basis for their support in law or in fact 31

POINT III.—The Secondary Allocation adopted by the District Court and approved by the Circuit Court of Appeals, which redistributed most of the cash and securities released by the huge wartime earnings on a pre-war basis predicated solely on what each of the mortgage divisions earned in the period 1936 to 1940 is unfair and inequitable and involves an important question of federal law which has not been but should be settled by this court 39

POINT IV.—The decision of the Circuit Court of Appeals holding that it was correct for the District Court to use the same level of earnings as a base for the distribution of junior securities as well as senior securities is erroneous and in conflict with applicable decisions of this court 45

POINT V.—The Circuit Court of Appeals erred in approving the allocation made to the Georgia and Alabama bondholders under the Plan of Reorganization where the District Court and Special Master failed to consider or apply the segregation formula adopted to the recent earn-

PAGE

ings in the years 1941 to 1943. The resulting allocations were obsolete and violated Section 77, subdivision (e) of the Bankruptcy Act 51

POINT VI.—The approved Plan of Reorganization is erroneous in that it fails to compensate the bondholders of the Georgia and Alabama Railway for the full amount of their claim and in that it allocates to said bondholders greatly inferior and junior securities in exchange for their first mortgage bonds 54

POINT VII.—The Segregation Formula adopted for the purpose of determining the earnings of each Mortgage Division and the resulting allocation of new securities is predicated upon false and artificial assumptions and hence is erroneous and inequitable 59

Distribution Under "Segregation Formula" to G. & A. Ry. 60

Definition and Purpose of a Segregation Formula 60

Problem 61

How Does One Ascertain the True Earning Power of Separate Mortgage Properties Which Comprise One System Operated as a Unit? 67

Basic Fallacy of the Adopted Segregation Formula 68

CONCLUSION 75

CASES CITED.

PAGE

Case v. Los Angeles Lumber Products Co., 308 U. S. 106 (1939) 58

Consolidated Rock Products Co. v. Du Bois, 312 U. S. 510 (1941) 58

Ecker v. Western Pacific R. Co., 318 U. S. 448, 468, 469 27

First National Bank v. Flershem, 290 U. S. 504, 515-516, 525-562 ..... 17, 30

Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pac. R. R. Co., 318 U. S. 561, 563 .....18, 49, 50, 61, 62, 63, 65

New England Coal & Coke Co. v. Rutland Railroad Co., 143 Fed. 2nd 179 .....15, 18, 26, 28, 29, 30

Southwestern Bell Telephone Company v. Public Service Commission, 262 U. S. 276, 310 62

Woods v. City National Bank and Trust Company of Chicago, *et al.*, 312 U. S. 262 ..... 17, 34

AUTHORITIES CITED.

Act of Feb. 13, 1925 (C. 229; 43 Stat. 938) amending Judicial Code, Section 240, Title 28, U. S. C. A., Section 347 23

Section 77 of Bankruptcy Act 3, 15, 24, 26, 29, 51, 62

Supreme Court Rule 38, par. 5 (b) 12, 15, 16, 18, 19, 23

Abbreviations.

G. & A. Ry.—Georgia and Alabama Railway.

System—Seaboard Air Line Railway Company.

Ct. Op.—District Court's Opinion.

Ct. Tr.—District Court Transcript of evidence of hearings held before Judge Chesnut and Judge Akerman jointly in Baltimore on Plan of Reorganization.

S. M. Tr.—Special Master's Transcript of evidence of hearings before Hon. Tazewell Taylor.

S. M. Rep.—Special Master's Report—Volume II.

Comp. Com.—Compromise Committee.

App.—Appendix.

Dist. Ct.—District Court.

Cir. Ct. Op.—Circuit Court of Appeals' Opinion.

All references made in this brief to the District Court Transcript and Special Master's Transcript of evidence as well as the Court Exhibits and Special Master's Exhibits are included for the Court's convenience in Appellant's printed appendix, Vol. I, unless otherwise noted.

Supreme Court of the United States

No. .....

TERM A. D. 1944.

F. G. BADENHAUSEN, WILLIAM S. SPATCHER and HOWARD H. HUBBARD, constituting the Protective Committee for the Holders of Georgia and Alabama Railway First Mortgage Consolidated Five Per Cent. Gold Bonds, Due 1945,

Petitioners and Appellants Below,

AGAINST

GUARANTY TRUST COMPANY OF NEW YORK and MERREL P. CALLAWAY, as Trustees of Seaboard Air Line Railway Company First and Consolidated Mortgage, dated September 1, 1915; *et al.*,

Respondents and Appellees Below.

In the Cause

of

Guaranty Trust Company of New York and Merrel P. Callaway, as Trustees, et al., Complainants v. *Seaboard Air Line Railway Company, et al., Defendants.* Consolidated Cause. In Equity No. 214. And in the constituent causes numbered 213, 214, 228, 229, 172, 173, 174, 237 and 238 of said consolidated cause.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petition of F. G. Badenhausen, William S. Spatcher and Howard H. Hubbard, constituting the Protective Committee for the Holders of Georgia and Alabama Railway

First Mortgage Consolidated Five Per Cent. Gold Bonds, Due 1945, respectfully shows:

Summary Statement of the Matter Involved.

The petitioners seek a review of the final determination of the United States Circuit Court of Appeals for the Fourth Circuit, dated August 2, 1944, which affirmed the decree of the District Court of the United States for the Eastern District of Virginia, entered on December 13, 1943, approving and confirming the Report of the Special Master and the Plan of Reorganization of the Seaboard Air Line Railway Company, recommended in said Report with certain modifications.

Petitioners constitute a Protective Committee for the Holders of Georgia and Alabama Railway First Mortgage Consolidated Bonds, Due 1945, one of the Underlying Mortgage issues of the Seaboard System.

Facts as to Seaboard System.

The Seaboard Air Line Railway Company has been in receivership in this Court for more than thirteen years.

These proceedings were inaugurated by the Bill of Complaint filed in the Receivership Court on December 23, 1930 by Bethlehem Steel Company, a general creditor, against Seaboard Air Line Railway Company, defendant, suing on its own behalf and on behalf of all other creditors who might thereafter join in the prosecution of said suit. The defendant Seaboard Air Line Railway consented to the Receivership. Ancillary proceedings were instituted on the same day in the District Court of the United States for the Southern District of Florida.

Thereafter, on January 15, 1931, Guaranty Trust Company of New York and Merrel P. Callaway, as Trustees of the First and Consolidated Mortgage of Seaboard Air Line Railway Company, filed their foreclosure bill against

the Seaboard System and its Receivers. Similar foreclosure bills were filed thereafter by the other general system mortgagees, to wit, the Trustees of the First Mortgage and the Trustees of the Refunding Mortgage. Subsequently, suits were instituted by several of the Trustees of the underlying mortgages, as well as by several of the Trustees of the mortgages on leased lines. In addition, a proceeding under Section 77 of the Bankruptcy Act was instituted for the reorganization of the Tampa Northern Railroad Company, a leased line.

However, pursuant to the authority granted the Seaboard Receivers by the Seaboard Receivership Courts, and with the approval of the Courts having jurisdiction over the other various properties including the leased lines or subsidiaries of the Seaboard System, the Receivers of Seaboard have remained in possession and have continued to operate all the properties of the System. As a result there was pending at the time the Special Master's Report was filed, in addition to the general creditors' suit, the following foreclosure bills: Three brought by the Trustees on the general system mortgages; seven brought by the Trustees of underlying mortgages, and two brought by the Trustees of mortgages of leased lines, as well as the proceeding under Section 77 of the Bankruptcy Act as to another leased line (the District Court subsequently directed that foreclosure proceedings should be instituted by the Trustees on the remaining lines in order to consummate the Plan of Reorganization in Equity Receivership). No action has been taken by the Trustee under the Seaboard Air Line Railway Adjustment Mortgage, the entire lien of which is subordinate to that of the Seaboard Air Line Railway Refunding Mortgage.

The present Seaboard Air Line Railway Company was organized in 1915 and is a successor to three successor Companies, each known as Seaboard Air Line Railway. It owns and operates more than 4,000 miles of railroad.

Included in the more than 4,000 miles of railroad owned by the Seaboard are over 2,000 miles which are subject to ten separate underlying divisional mortgages. The total principal and unpaid interest on which (held by the public) as of January 1, 1943, amounted to $48,549,767.20. Subordinate to these underlying liens, but constituting first liens on certain portions of the whole railroad system are four general mortgages known as (1) First Mortgage 4% bonds due April 1, 1950; (2) Refunding Mortgage 4% bonds due October 1, 1959; (3) First and Consolidated Mortgage 6% bonds, series A, due September 1, 1945, and (4) Adjustment Mortgage 5% bonds due October 1, 1949. The total principal and interest of these general mortgage bonds publicly held, aggregates $160,439,473.33. In addition there are $36,806,862.55 of Seaboard collateral trust obligations. The general unsecured claims against the Seaboard not entitled to priority of payment ahead of mortgage liens (as of August 1, 1942), principal and interest, amounted to $1,193,723.97). The par value of the outstanding capital stock of the Seaboard Air Line Railway Company, preferred and common, aggregates $85,110,662.21. During the course of the receivership the Receivers incurred obligations represented by outstanding receivers' equipment trust certificates in the amount of $13,531,000, and receivers' certificates in the amount of $23,128,000, and other indebtedness, aggregating in all $38,412,882.37. The grand total of principal and interest of the secured debt in the hands of the public is $221,362,460.25, on which there is unpaid interest amounting to $118,889,124.39, a total of principal and interest of $340,251,484.64, exclusive of capital stock.

During the course of the receivership, principally in the last two years, the Receivers have purchased and acquired about $34,000,000 par value of outstanding receivers' certificates and other secured obligations of the System. Nearly all of the securities were acquired by

the Receivers under orders of court to the effect that the application of the moneys therefor should be without prejudice to the claims of parties in interest with respect to the application of the moneys so used. And during the receivership the Receivers have also applied upwards of $50,000,000 in betterments to the railroad system.

During the receivership several efforts were made by the Court to effect a Plan of Reorganization. In 1935, the Court instructed the Receivers to prepare a Plan of Reorganization. Extended studies and tentative proposals were made by the Receivers but the then relatively poor earnings of the railroad caused the principal secured creditors to oppose further procedure along this line at that time; and the Receivers were then excused by the Court from further activities in that direction. On October 27, 1939 the Court entered an order appointing Tazewell Taylor, Esq., as Special Master, to prepare and submit a Plan of Reorganization after hearing all parties in interest. The appointment was made pursuant to Rule 53 of the Rules of Civil Procedure. The Master conducted hearings, took evidence for a period of over three years, considered various plans of reorganization and on July 20, 1943, submitted his Report which is included in this Record on Appeal.

After the receipt of the Report, Judge Way entered an order notifying the parties in interest to file any objections or exceptions which they wished to make to said Report, and set the date for hearing the same on October 18, 1943. Exceptions and objections to the Plan of the Special Master were filed by many parties including the petitioners herein. The hearing was adjourned (due to the regrettable illness and subsequent death of Judge Way) to October 25, 1943, when the hearing was held jointly by Judge Chesnut, sitting for the United States District Court, Eastern District of Virginia, and Judge Akerman, sitting for the United States District Court, Southern Dis-

trict of Florida, the presiding Judge in the ancillary proceedings. All parties in interest were heard for a period of two weeks and further evidence was submitted. At the close of these hearings, on the objections to the Plan, the Court appointed a Compromise Committee composed of three representatives of *certain* secured creditors to consider and propose modifications of the Plan of Reorganization submitted by the Special Master with the view that it should compromise, if possible, *all* conflicting claims. The Committee consisted of Messrs. Delano Andrews and Edwin S. S. Sunderland who represented the Bondholders Protective Committee and Trustees, respectively, of the First and Consolidated 6% Mortgage of the Seaboard System, the third member, Mr. France, who was counsel for the Underlying Bondholders Committee, which had on deposit bonds of all ten of the Underlying Mortgage Divisions purported to represent all of these *conflicting* mortgage divisions. The Compromise Committee adopted the attitude it was functioning in a *judicial capacity* rather than as a negotiating or arbitrating body (Vol. I, Comp. Com. Exh. 1, pp. 415, 417, 418, 420).* The Committee, after purportedly hearing certain interested parties objecting to the Plan, submitted its recommendations and report for modification of the allocation of the new securities. A further hearing was then held on these proposed modifications by the Compromise Committee, before the District Court. At the hearing and in their Report, the Compromise Committee gave no reasons nor did they explain the methods by which they obtained the results they recommended but stated that the results were obtained from the exercise of an informed judgment (Vol. I, Comp. Com. Exh. I, p. 418). Thereafter the Plan submitted by the Special Master, with the modifications recommended by the Compromise Committee, was adopted by the District Court.

*Numerical references are to pages contained in appellants' printed Appendix of Record on Appeal designated Vol. I unless otherwise noted.

The District Court found that the Seaboard was insolvent according to both the equity and bankruptcy definitions. It found that the unsecured debt and stock of the Seaboard railroad were not entitled to participate in a reorganization because the new capitalization would be insufficient to fully satisfy the claims of the holders of the secured debt (Vol. I, Dist. Ct. Op. p. 91).

Facts as to the Georgia and Alabama Railway.

The Georgia and Alabama Railway First Mortgage Consolidated Five Per Cent. Bonds, Due October 1, 1945, are a first mortgage lien on approximately 393.53 miles of railroad in the States of Georgia and Alabama, extending generally from Savannah, Georgia, westward to Montgomery, Alabama. The mortgage carries a lien on equipment acquired for use on the mortgagor's line of railroad. There is a lease between the Georgia and Alabama Railroad and the Central of Georgia Rd. dated March 28, 1896, covering an additional 57.48 miles of main track from Meldrin, Georgia, to Lyons, Georgia, at an annual rental in the sum of $43,000.

There are Georgia and Alabama bonds issued and still outstanding in the principal sum of $6,085,000 with accrued interest due and unpaid in the sum of $3,803,125. The total claim amounts to $9,888,125 or $1.625 per $1,000 bond.

The valuation of the G. & A. Ry. as fixed by the Master in his Plan of Reorganization was $1,419,029. The Master's Plan of Reorganization allocated to the bondholders of G. & A. Ry.:

Income Bonds	$1,599,640—Valued at	$799,820
Preferred Stock	659,797—Valued at	164,949
Income Stock	3,748,748—Valued at	468,594
Total	$6,008,185—Valued at	$1,433,363

Under the Master's Plan each Georgia and Alabama bond on which there was accrued principal and interest in the sum of $1,625 received the following:

Income Bond	$260.25
Preferred Stock	107.35
Common Stock	609.90
Total Face Value	$977.50

In his allocation of new securities, the Master allocated all of the First Mortgage Bonds of the new company only to such divisions as have shown earnings under a segregation formula adopted by him, known as the "Kennedy Segregation Formula."

In his allocation of Income Bonds the Master allocated fifty per cent. of the Income Bonds on the basis of segregated earnings and fifty per cent. on the basis of net value of freight contributions. In his allocation of Preferred Stock and Common Stock, the Master has allocated one-third on the basis of segregated earnings, one-third on the basis of net value of freight contributions and one-third on the basis of reproduction costs new, less depreciation including land and rights of way (Vol. II, S. M., Report, pp. 227 to 258).

Under the Master's Plan, G. & A. Ry. received no First Mortgage Bonds due to the fact that under the Master's Segregation Formula, G. & A. Ry. showed no segregated earnings.

Under the Master's Plan, G. & A. Ry. in view of the net value of its freight contributions received Income Mortgage Bonds in the sum of $1,599,640, Preferred Stock in the sum of $373,903 and Common Stock in the sum of $2,129,517.00.

Under the Master's Plan the estimated cost of reproduction new less depreciation of the G. & A. Ry. including

land and right as of December 31, 1941 is $7,886,829. Based on this valuation, the Master's Primary Allocation allots to the G. & A. Ry. Preferred Stock in the sum of $285,894 and Common Stock in the sum of $1,619,231.

As stated heretofore, during the course of the receivership and principally, in the 1942 and 1943 years the Receivers have purchased and acquired $34,000,000 outstanding Receivers' certificates and other secured obligations of the System (Vol. I, Dist. Ct. Op. p. 90). These securities were purchased by the Receivers with funds which were principally acquired from the huge wartime earnings accumulated during the years 1942 and 1943. The net earnings for the Seaboard System for the year 1942 were $34,566,102 and the net earnings for the Seaboard System for the year 1943 were estimated at about $28,000,000 (Vol. I, Dist. Ct. Op. pp. 96, 123). The purchase of these securities and cash provisions subsequently provided for other issues, released for reapportionment large amounts of new securities which were originally allotted by the Master in his Primary Allocation to these purchased securities and outstanding issues under his Plan of Reorganization. The effect or result of these purchases was to require a Secondary Allocation which would reallot these securities to the remaining secured creditors of the Seaboard System.

Under the Master's Plan, the Secondary Allocation was to be reallotted solely on the basis of the segregated earnings which were based on the earnings of the average year for the period 1936 to 1940, predicated on the "Kennedy Segregation Formula" (Vol. II, M. Rep., 235-258). Under the Master's Plan the G. & A. Ry. did not participate in the Secondary Allocation as it purportedly failed to show any segregated earnings during the period of 1936 to 1940. No consideration was given to the fact that in 1942, when the huge wartime earnings were accumulated by the System, the G. & A. Railway Division earned $1,016,937 (Vol. I, Wyer, Ct. Exh. 1, p. 409) and

that its earnings in 1943 were probably 1½ to 2 million dollars (Vol. I, Ct. Tr. 158-163).

It was recognized by the District Court and practically all of the parties in interest that these huge wartime earnings were entirely due to traffic contributed by the various underlying divisional lines and that all the underlying divisional lines were earning huge sums during the years 1942 and 1943, particularly those lines which under the Special Master's Segregation Formula on the basis of the average year for a period of 1936 to 1940 were denoted as "deficit lines" (Vol. I, Ct. Tr. 325-327, 346-347, 360; Comp. Com. Exh. 1, p. 419). It was contended by the petitioners that the Secondary Allocation of the new securities should be made in a court of equity on an earnings basis to the owners of those properties whose earnings produced the cash used by the Receivers to acquire the released securities and not on a pre-war earnings basis predicated on the period 1936 to 1940, when the earnings of the System were on a much lower level.

The Compromise Committee recognized and admitted the fairness and soundness of this principle, in its report (Vol. I, Comp. Com. Exh. 1, p. 419), and recommended the adoption of the Tertiary Allocation (Vol. I, Comp. Com. Exh's. 2 and 4, pp. 426, 428).

The Tertiary Allocation in effect distributed some of the new securities released by the Receivers' recent purchasers among the various mortgage liens on the basis that they were dividends earned, and being paid, for a period of two years, on the securities originally alloted by the Special Master to the several mortgages, in his two prior allocations, *but* the Tertiary Allocation was *not* applied to *all* the securities released for reapportionment by reason of the Receivers' purchases from wartime earnings. The Tertiary Allocation applied to only a small portion of the new securities released; the bulk of the securities, released by the Receivers' wartime pur-

chases or cash provisions subsequently provided for certain mortgage issues, were distributed under the Master's Secondary Allocation, which was based purely on segregated earnings shown under the Kennedy Formula for the average year 1936 to 1940. It will be noted that in effect the approved Plan of Reorganization contains three different allocations: The Primary and Secondary Allocations recommended by the Master and the Tertiary Allocation which partially modified the Secondary Allocation with respect to a portion of the securities released by the Receivers' recent purchases from wartime earnings.

It will be further noted that the District Court, in approving the Modified Plan of Reorganization, was under the erroneous impression (as indicated in its opinion Vol. I, p. 119, fol. 355) that a block allotment had been made to the Georgia and Alabama Division in the modifications recommended by the Compromise Committee. On the contrary, no such block allotment appears in the record, other than that granted to the Atlantic-Birmingham Division, which consisted of First Mortgage Bonds in the sum of $280,057, Income Bonds $320,392, Preferred Stock $55,457 and Common Stock $315,266. The additional securities received by the Georgia and Alabama Division are solely the result of the Tertiary Allocation made to all of the divisions and this fact was admitted by the respondents in their brief before the Circuit Court of Appeals.

As a result of the Tertiary Allocation, Georgia and Alabama Railway received the following additional securities: First Mortgage Bonds $357,408; Income Bonds $13,983; Preferred Stock $3,262; Common Stock $28,614. The additional securities are valued at $368,798, making a total valuation of all securities received by the Georgia and Alabama Railway in the amount of $1,787,871 (Vol. III, p. 27).

Under the Plan of Reorganization as modified by the Court, the bondholders of the G. & A. Ry. receive the following securities per $1,000 bond:

1st Mortgage	*Income Bond*	*Pref. Stock*	*Com. Stock*
58.74	262.55	107.88	614.61

The total face value of the above securities amounts to $1,043.78 whereas the total first lien claim of each G. & A. bond for principal and accrued interest to Jan. 1, 1944 is $1,625.

This Court Has Jurisdiction.

The jurisdiction of this Court to review the judgment here in question is invoked under the Act of February 13, 1925 (C. 229; 43 Stat. 938) amending the Judicial Code, Sec. 240, Title 28, U. S. C. A., Sec. 347, and under Rule 38, subdivision 5, of the Rules of the Supreme Court.

The date of the entry of the judgment of affirmance of the Circuit Court of Appeals sought to be reviewed is August 2, 1944 (Vol. III, pp. 39-40). By order of Mr. Chief Justice Harlan F. Stone dated Oct. 27, 1944 the time to file the petition herein has been extended to Dec. 2, 1944.

To avoid repetition and in the interest of brevity a statement of the actual grounds on which the jurisdiction of this Court is invoked under Rule 38 subdivision 5 of the Rules of the Supreme Court is not presented here and petitioners respectfully refer the Court to the following portions of this petition, which present these questions fully.

Questions Presented.

The questions presented herein involve important questions of both procedural and substantive law, which call for their most authoritative determination. It is contended that the procedure adopted by the District

Court and sanctioned by the Circuit Court of Appeals exceeded the jurisdiction of the Court and so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's jurisdiction. The substantive questions set forth must be considered to determine the basic problem of whether the allocation of new securities, to be issued in the approved Plan of Reorganization among the various classes of mortgagees having claims of equal rank against different properties, is fair and equitable.

1. Did the District Court err in proceeding to reorganize the Seaboard System in equity, after the passage of Section 77 of the Bankruptcy Act?

2. Did the appointment by the District Court of a Compromise Committee consisting only of representatives of certain partisan interests, which purported to act in a judicial capacity upon issues affecting the petitioners as well as the other bondholders of the System, violate the due process of law guaranteed by the Federal Constitution?

3. Did the Circuit Court of Appeals, in sanctioning the procedure of the District Court with respect to the Compromise Committee, so far depart from the accepted and usual course of judicial proceedings or so far sanction such a departure by a lower court as to call for an exercise of this Court's power of supervision?

4. Do the allocations of securities to the various classes of bondholders, recommended by the Compromise Committee and adopted by the District Court, have any basis for their support in law or in fact, or were they arbitrary determinations made in violation of the due process clause contained in the Federal Constitution?

5. Did the Circuit Court of Appeals and District Court err in using the same level of earnings as a base for the distribution of junior securities as well as for the distribution of senior securities?

6. Was the distribution of wartime earnings and redistribution of securities released by purchases from the huge wartime earnings on a pre-war basis predicated solely on what each of the mortgage divisions earned in the period 1936 to 1940 under the Secondary Allocation adopted by the Courts below, fair and equitable to all the mortgage divisions, particularly those divisions whose properties produced such earnings but who showed no segregated earnings during the average period of 1936 to 1940?

7. Did the failure of the Special Master and the courts below to apply the "Kennedy Segregation Formula" to the recent earnings in the years 1941 to 1943 render the results so obtained obsolete and hence inequitable?

8. Was the "Segregation Formula" adopted by the lower Courts to ascertain the earnings of the various mortgage divisions of the System which primarily determined the allocation of most of the new securities, equitable, based upon false, artificial and inequitable assumptions?

9. Was the weight given by the Master and the Courts below to the socalled "segregated earnings" of the different mortgage divisions under the adopted "Kennedy Formula", predicated on false and artificial assumptions, equitable?

10. Did the District Court err in determining the earnings and relative value of the Georgia and Alabama Division by considering it as a separately operating railroad instead of as part of a System operated as a unit?

11. Were the G. & A. Railway Bondholders fairly and equitably compensated for the full amount of their claims and the loss of their first mortgage position?

Reasons Relied on for Allowance of Writ.

1. The decision of said Circuit Court of Appeals, approving the procedure of the District Court in proceeding to reorganize the Seaboard Railway System in equity, after the passage of Section 77 of the Bankruptcy Act, is in direct conflict with the decision of the Circuit Court of Appeals, Second Circuit, on the same matter, in the case of *New England Coal & Coke Co.* v. *Rutland Railroad Co.*, 143 Fed. 2nd 179. The Circuit Court of Appeals, Second Circuit held that, before the enactment of Section 77. railroad reorganizations in equity were approved because the Bankruptcy Act was not applicable to railroad corporations and reorganization in equity was necessary in the public interest, but that, after the enactment of Section 77 that reason for condoning such a receivership has vanished and equity reorganization is now "a means for the frustration of the public policy of the United States, embodied in Section 77".

The decision of said Fourth Circuit Court of Appeals, affirming the correctness of the procedure and jurisdiction of the District Court, to proceed with the reorganization of a railroad in equity receivership, after the enactment of Section 77 of the Bankruptcy Act, involves an important question of federal law which has not been but should be settled by this Court (Supreme Court Rule 38, par. 5[b]). The question involved has a public aspect and is of public importance to all railroads now in the process of reorganization, and it is essential in the public interest that the question be reviewed and finally settled.

2. The decision of said Circuit Court of Appeals, sanctioning the procedure adopted by the District Court,

of appointing a Compromise Committee consisting of representatives only of certain major and partial interests to act in a judicial capacity upon issues and allocations before the District Court, was improper, erroneous, violated the due process of law guaranteed by the Federal Constitution, and so far departed from the accepted and usual course of judicial proceedings or so far sanctioned such a departure by a lower court as to call for an exercise of this Court's power of supervision (Supreme Court Rule 38, par. 5[b]).

All of the members of the Compromise Committee had prejudicial interests. Two members of the Compromise Committee represented the Bondholders Protective Committee and the Trustees, respectively, of the System's First and Consolidated Six Per Cent. Mortgage, the largest General System Mortgage, which acted for all of the System General Mortgages. The third member of the Committee appointed and the only representative of the Underlying Mortgage Divisions was counsel for the "Underlying Bondholders Committee", which purportedly represented *all* ten of the Underlying Divisions because it had on deposit substantial amounts of bonds of all the Underlying Mortgage Divisions. A *conflict of interest* existed between each one of the Underlying Mortgage Divisions since the treatment received by each division was different under the proposed Plan. This conflict of interest became more apparent and pronounced between the socalled "earning divisions" and "deficit divisions". The G. & A. Division under the Segregation Formula adopted was designated a "deficit division". It became apparent early in the proceedings that the Underlying Bondholders Committee favored the socalled "earning divisions" represented by it.* The petitioners attacked the position of the Underlying Bondholders Committee and filed a petition** before the Dis-

*This fact was admitted at a subsequent hearing on the petition hereinafter mentioned.

**This petition was subsequently denied by the District Court and an appeal from this decision is now pending before the Circuit Court of Appeals.

trict Court during the course of the proceedings to direct the Underlying Bondholders Committee to cease to represent the Bondholders of the Georgia and Alabama Railway, in view of the sharp conflict of interest which existed between each of the various liens. This position, petitioners contended, was fully supported by this Court in the case of *Woods* v. *City National Bank and Trust Company of Chicago, et al.*, 312 U. S. 262. It is apparent from the record that the attitude of the Underlying Committee and its counsel toward the Georgia and Alabama petitioners and representatives was a most hostile one and that the presence of the counsel for the Underlying Bondholders Committee on the Compromise Committee was not conducive to improving the treatment of the G. & A. Bondholders.

Nevertheless, the Compromise Committee asserted in its report that they were acting as judicial officers of the Court and were exercising an *impartial informed judgment* as to the various adjustments recommended by said Committee (Vol. I, Comp. Com. Ex. 1, pp. 415, 417-418, 420). The Compromise Committee gave no reasons and did not explain the methods by which it obtained the results it arbitrarily recommended, but stated they were obtained from the exercise of an informed judgment (Vol. I, Comp. Com. Exh. 1, pp. 415, 417-418, 420). The modifications recommended by the members of the Compromise Committee were in effect a judgment in their own favor. The District Court's approval in Equity of the Plan of Reorganization as modified was predicated substantially upon the fact that most of the Debenture Holders had assented to the Plan (Vol. I, Dist. Ct. Op., pp. 134, 137, 141-142). It is clear that the just and equitable rights and claims of a minority group of creditors should not be prejudiced or waived through the coercion of a majority of the other secured creditors who would benefit thereby (*First National Bank* v. *Flershem*, 290 U. S. 504, 515-516;

New England Coal & Coke Co. v. *Rutland Railroad Co., supra*). The District Court in accepting the arbitrary modifications recommended by a partial Compromise Committee, without any basis in law or fact for the support of said modifications, violated the due process of law guaranteed by the Federal Constitution.

3. The decision of said Circuit Court of Appeals, holding that it was correct for the District Court to use the same level of earnings as a base for the distribution of junior securities as well as for the distribution of senior securities, is a decision of a federal question in a way probably untenable and in conflict with applicable decisions of this Court (*Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pac. R. R. Co.*, 318 U. S. 561, 563) (Supreme Court Rule 38, par. 5[b]).

It is estimated that if a higher level of earnings was adopted for the distribution of junior securities predicated for example on the actual 1942 earnings, the Georgia and Alabama Division would have received additional junior securities in the following amounts: Income Bonds $780,000; Preferred Stock $150,000; Common Stock $850,000.

4. The Circuit Court of Appeals erred in approving the allocation made to the G. & A. bondholders under the Plan of Reorganization, where the District Court and the Special Master admittedly failed to apply the Segregation Formula to or consider the recent earnings in the years 1941 to 1943. The results so obtained were obsolete and violated Section 77, subdivision (e) of the Bankruptcy Act which provides that the value of any property used in railroad operation shall be determined on a basis which shall give due consideration to the earning power of the property, *past, present and prospective*, and all other relevant facts.

5. The Circuit Court of Appeals erred in affirming the Master's Secondary Allocation approved by the District Court. The Secondary Allocation re-distributed securities released by purchases from recent wartime earnings, on a pre-war earnings basis, and gave no consideration whatsoever to the recent earnings of each of the various Mortgage Divisions whose properties produced such earnings in the years 1941 to 1943. The question as to whether the wartime earnings (or securities released by purchases from wartime earnings) in a railroad reorganization, should be distributed among the various Mortgage Divisions on an actual earnings basis during those years *when* they were *acquired* or whether the funds and securities so acquired should be distributed among the various Mortgage Divisions on a *pre-war basis* and in different pre-war ratios, contrary to the actual facts, has never been adjudicated by this Court, so far as our research indicates. It involves an important question of federal law of great importance to the public and other railroads presently in reorganization. It involves an important question of federal law which has not been but should be settled by this Court (Supreme Court Rule 38, par. 5[b]).

In the instant case the securities involved and which must be redistributed are in excess of $34,000,000. Under the Secondary Allocation adopted by the lower Courts most of these securities have been distributed to the various mortgage divisions on an earnings basis made in a synthetic average year for the period 1936 to 1940. Many of the mortgage divisions showed no net earnings during this period and were designated as "deficit lines" in these years under the Segregation Formula adopted, whereas in the years the wartime earnings were accumulated all of these socalled "deficit lines" admittedly became huge earnings lines which produced much of the cash or equivalent securities now being distributed in

which they do not participate. It is estimated that the Georgia & Alabama division would have received additional securities in the amount of $1,315,800 if all the released securities were properly reallocated.

6. The decision of the said Circuit Court of Appeals approving the results obtained under the Segregation Formula adopted by the District Court was erroneous, for the following reasons:

(a) The Segregation Formula was predicated upon the false and artificial premise that each Mortgage Division was a separate operating railroad. The Segregation Formula should have been based upon the consideration and ascertainment of the relative earnings of each Division as a part of one System operated as a unit.

(b) To ascertain the earnings of each mortgage division as a base for establishing the consequent relative value of the several divisions, the earnings intended to be ascertained were the earnings of the System through the use and operation of each mortgage division, not the earnings of each segment, as if it were a separately operating railroad.

(c) The Segregation Formula adopted attempted to put precise mathematical values on each separate division of the Railroad System without considering or ascertaining their relative value to the System.

7. There is no rule of law which prescribes the criteria for the determination of earnings of separate railroad divisions in one system. The principles and rules adopted by the District Court and affirmed by the Circuit Court of Appeals for the ascertainment of the earnings as well as the relative values of the separate railroad divisions which comprised the Seaboard System, involve important questions of federal law which

have not been but should be settled by this Court, and have been decided in a way probably in conflict with applicable decisions of this Court. Under Section 77 of the Bankruptcy Act these questions and principles have been left to the expert and informed judgment of the Interstate Commerce Commission but the Interstate Commerce Commission does not have authority to determine these questions in an equity receivership. The reorganization of railroads, both in equity and bankruptcy has become increasingly frequent and it may reasonably be assumed from past experience that such reorganizations will occur in the future. It is essential in the public interest that the questions here presented be reviewed and finally settled.

8. The interests at stake and the number of persons affected are very substantial. Involved herein is the distribution among various secured creditors of securities in the sum of approximately $197,000,000. Involved also are the rights of many thousands of general creditors spread throughout our land who rightfully look to the courts for a fair and equitable administration and distribution of this insolvent estate, nor is this merely a controversy between private interests in the usual sense, since the questions involved concern hundreds of thousands of investors who daily trade in these securities and others of similar character.

The public interest and administration of justice will be subserved by this Court's review and by the correction of the patent discrimination and injustice which petitioners believe to inhere in this proceeding.

Wherefore your petitioners respectfully pray that a writ of certiorari issue under the seal of this Court directed to the Circuit Court of Appeals for the Fourth Circuit, commanding said Court to certify and send to

this Court a full and complete transcript of the record and of the proceedings of the said Circuit Court, had in the case numbered on its Docket 5249, to the end that this cause may be reviewed and determined by this Court, as provided for by the statutes of the United States, and that the judgment herein of said Circuit Court be reversed by this Court, and for such other relief as to this Court may seem proper.

Dated, November 27, 1944.

ABRAHAM MITNOVETZ,
Counsel for Petitioners.

HARRY O. LEVIN,
Of Counsel.